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No. _____

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In the
Supreme Court of the United States
October Term, 1992

JAMES JOHN CHICA,

Petitioner,

v.

JUDY LEE,

Respondent.

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the enforcement of a punitive damages arbitration award against petitioner Chica, who was not a party to the arbitration agreement, violated Chica's due process rights where he was not afforded the procedural safeguards available in judicial proceeding and approved by this Court in Pacific Mut. Life Ins. Co. v. Haslip, 111 S.Ct. 1032 (1991).

2. Whether, in enacting the Federal Arbitration Act, Congress intended the federal courts to develop a federal common law of contracts preempting state law which reserves to the state the power to punish by punitive damages, thereby subjecting petitioner Chica to a punitive arbitration award prohibited by Minnesota law.

3. Whether, in enacting the Federal Arbitration Act, Congress intended a federal common law of contracts to preempt general state contract law governing who is a party to an arbitration agreement, thereby subjecting petitioner Chica to an arbitration award when he was not a party to the arbitration contract under state law.

LIST OF PARTIES

All Parties to this Petition are listed in the caption.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1992

JAMES JOHN CHICA,

Petitioner,

v.

JUDY LEE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

James John Chica petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this case.

OPINIONS BELOW

The Eighth Circuit's opinion is reported at 983 F.2d 883 and is set forth in Appendix A. (App. 1-13.) The Eighth Circuit's order granting the Securities Industry

Association, Inc. leave to file a petition for rehearing en banc as amicus curiae is not reported and is set forth in Appendix B. (App. 14.) The Eighth Circuit's denial of rehearing and rehearing en banc by a five to six vote is not reported and is set forth in Appendix C. (App. 15.) The oral ruling of the United States District Court for the District of Minnesota vacating the punitive damage portion of the arbitration award and confirming the compensatory portion of the award is not reported and is set forth in Appendix D. (App. 16-18.) The written order of the United States District Court for the District of Minnesota is not reported and is set forth in Appendix E. (App. 19-20.) The award of the arbitrators is not reported and is set forth in Appendix F. (App. 21-23.)

JURISDICTION

On January 12, 1993, the Eighth Circuit entered judgment by a divided vote. On March 4, 1993, Chica's petition for rehearing and rehearing en banc was denied by a five to six vote. This petition was filed within 90 days of the Eighth Circuit's denial of Chica's petition for rehearing. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254.

STATUTES AND RULES INVOLVED

Amendment V to the United States Constitution provides, in relevant part:

> No person shall . . . be deprived of life, liberty, or property, without due process of law . . . .

9 U.S.C. § 2 provides, in relevant part:

> A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 9 provides, in relevant part:

> If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court, then at any time within one year after the award is made any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title. . . .

9 U.S.C. § 10(a)(4) provides, in relevant part:

> (a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration--
>
> * * *
>
> (4) Where the arbitrators exceeded their powers, . . .

9 U.S.C. § 11(b) provides in relevant part:

> In either of the following cases the United States court in and for the district wherein the award was made may make an order modifying or correcting the award upon the application of any party to the arbitration--
>
> * * *
>
> (b) Where the arbitrators have awarded upon a matter not submitted to them, . . .

STATEMENT OF THE CASE

This case involves the spread of the much criticized, quasi-criminal sanction of punitive damages to the arbitration process. The Eighth Circuit, reversing the trial court, held that petitioner, James Chica, was bound by a punitive damage arbitration award, even though he was not a party to the arbitration agreement and did not participate in the arbitration. The Eighth Circuit also ruled that the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1 et seq., allows private arbitrators to impose punitive damages contrary to state law which reserves to the state the power to punish by punitive damages. This preemption of state law completely federalizes the arbitration process, and results in an unprecedented expansion of the power of private court systems which now decide thousands of disputes formerly resolved by the public courts.

Background

Respondent Judy Lee ("Lee") had a securities account with the now defunct Engler-Budd & Company, Inc. ("Engler-Budd"), a broker dealer and a member of the National Association of Securities Dealers. (App. 2.) Petitioner Chica was Lee's account representative while Lee had her account at Engler-Budd. Id.

Lee signed a Customer Agreement with Engler-Budd. The agreement between Lee and Engler-Budd contained an arbitration clause providing that, "If any controversy arises out of this agreement, it shall be determined by arbitration, except where prohibited by law." (App. 3.) The agreement and its enforcement were to "be governed by the laws of the State of Minnesota", and any arbitration thereunder was to be conducted under the rules of the American Arbitration Association ("AAA"). (App. 3.)

Chica, acting as an agent for a disclosed principal, his employer Engler-Budd, presented the agreement to Lee, who signed it. Chica is not a party to the customer agreement and did not sign it. (App. 3.)

Lee filed a demand for arbitration with the AAA against Chica individually and also against Engler-Budd. Lee alleged that Chica and Engler-Budd had violated the Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b); the Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5; the Securities Act of 1933, 15 U.S.C. §§ 77a-77bbb; and the Minnesota Securities Act, Minn. Stat. Ch. 80A. Lee also alleged state common law claims of negligence, fraud, and breach of fiduciary duty. (App. 3.) Lee's arbitration demand also sought punitive damages.

Chica did not sign the AAA arbitration submission agreement, did not answer the arbitration complaint, and made no appearance at the arbitration. (App. 4.)

In December 1990, an AAA arbitration panel held a hearing. Id. The AAA did not keep a record or transcript of proceedings before it. Accordingly, there is no record as to what evidence, if any, was presented at the arbitration hearing.

The arbitrators awarded Lee $31,800 in punitive damages, $10,600 in compensatory damages, and $5,000 in attorneys fees against both Chica and Engler-Budd. (App. 4).[1]

The District Court's Order

Lee filed a motion to confirm the award in the Minnesota federal district court under Section 9 of the FAA. 9 U.S.C. § 9. The district court had subject matter jurisdiction under Section 27 of the Securities and Exchange Act of 1934. 15 U.S.C. § 78aa. This statute gives federal district courts exclusive jurisdiction over all proceedings to enforce any liability created by the 1934 Act. Id. As Lee's arbitration complaint alleged violations of Section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), the motion to confirm the award issued thereon was a proceeding to enforce a liability under the 1934 Act within the district court's jurisdiction under Section 27. 15 U.S.C. § 78aa.

Chica opposed Lee's petition and moved to vacate the award under 9 U.S.C. §§ 10(a)(4) and (11)(b). Chica argued the entire arbitration award should be vacated because he was not a party to the arbitration agreement and did not submit to the AAA's jurisdiction. As a matter of general Minnesota contract law, Chica, acting as agent for a disclosed principal, his employer Engler-Budd, was not a party to the arbitration agreement. Kost v.

[1] Engler-Budd, now defunct, did not participate in the arbitration or district court proceedings and was not a party to the appeal to the Eighth Circuit. Engler-Budd's liability is not at issue in this petition. (App. 4, n.2).

Peterson, 292 Minn. 46, 49, 193 N.W.2d 291, 294 (Minn. 1971). Chica argued he was not bound by the award because the arbitration "contract is that of the principal [Engler-Budd] and does not give rise to any contractual obligation running to the agent [Chica]." Id.

Chica asked the court to apply this general state contract law, and rule that as a non-party he was not subject to the arbitrators' jurisdiction and not bound by the award. Chica relied on Perry v. Thomas, 482 U.S. 483, 492-93 n.9 (1987). In Perry, this Court said that in determining the enforceability of arbitration contracts, "state law, whether of legislative or judicial origin, is applicable if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." Id. 482 U.S. at 492-93 n.9 (emphasis in original). Chica argued the award should be vacated because, by issuing an award against a person who was not a party to the arbitration agreement, the arbitrators "exceeded their powers," 9 U.S.C. § 10(a)(4), and "awarded upon a matter not submitted to them," 9 U.S.C. § 11(b).

Alternately, Chica asked the district court to at least vacate the punitive damage portion of the arbitration award on the ground the arbitrators lacked the power to impose punitive damages under Minnesota law. Many states, including Minnesota, do not permit private persons to inflict the punishment of punitive damages, even by agreement. These states reserve to the government, through the courts, the power to punish. Chica argued that, by violating the Minnesota law prohibition on punitive arbitral awards, the arbitrators "exceeded their powers," 9 U.S.C. § 10(a)(4), and "awarded upon a matter not submitted to them," 9 U.S.C. § 11(b).

The district court accepted Chica's argument that Minnesota law prohibited an award of punitive damages by an arbitration panel (App. 4). The district court noted

that the arbitration clause in the customer agreement incorporated Minnesota state law to govern the contract. (App. 4.) Therefore, the district court reasoned that the parties had intended to limit the scope of recovery to that which would be allowed by Minnesota law, which did not include punitive damages. (App. 4.)

The district court rejected Chica's argument that it should apply general state contract law to determine whether Chica was bound by the compensatory award. It applied a perceived federal common law of contracts and ruled that under federal law Chica was bound by the compensatory portion of the award. (App. 4, 17.)

Accordingly, the district court vacated the $31,800 punitive damage portion of the arbitration award, and confirmed the compensatory portion of the award. (App. 19-20.)

The Eighth Circuit's Decision

Lee appealed to the Eighth Circuit seeking reversal of the district court's order vacating the punitive arbitral award, pursuant to 9 U.S.C. § 16(a)(1)(D) and (E) and 28 U.S.C. § 1291. Chica cross-appealed seeking reversal of the district court's order to the extent it confirmed the compensatory portion of the award, pursuant to 9 U.S.C. § 16(a)(1)(D) and (E).

The Eighth Circuit affirmed the trial court order confirming the compensatory award. It ruled that federal law, and not state law, governed the question of whether Chica, who did not sign the arbitration agreement and refused to participate in the arbitration, was subject to the jurisdiction of the arbitrators. The Eighth Circuit ruled that Perry's direction to apply general state contract law, 482 U.S. at 492-93 n.9, did not apply when the court was considering a motion to confirm or vacate an award. (App. 6). The court also ruled the arbitrators had the power to determine their own jurisdiction under the agreement. (App. 7 at n.4).

The Eighth Circuit acknowledged the apparent inconsistency in its own opinions, noting "there is dicta in Flink v. Carlson, 856 F.2d 44, 46 (8th Cir. 1988), which supports Chica's argument that, as an agent for a disclosed principal, he cannot be bound personally by the customer agreement." (App. 7 at n.5.) In Flink the court had ruled that "federal courts look to state law" to resolve the issue of whether a broker is bound to arbitrate, and held that "[s]igning an arbitration agreement as agent for a disclosed principal is not sufficient to bind the agent to arbitrate claims against him personally." 856 F.2d at 46 and n.2.

A divided panel reversed the district court order vacating the punitive damages portion of the arbitration award. The majority ruled that as a matter of federal law, AAA arbitrators had the power to impose punitive damages, regardless of whether Minnesota law was to the contrary. (App. 9.) It also employed a "very limited" standard of review, ruling that an arbitration award could not be set aside "unless it is completely irrational or evidences a 'manifest disregard for law.'" (App. 5, 10).

Judge Beam dissented from the majority's holding that the arbitration panel could award punitive damages. (App. 11-13.) He concluded that the rules of the AAA, which do not refer to punitive damages, do not contemplate the award of punitive damages. (App. 11-13.) He further concluded that even if the AAA rules could somehow be construed to allow arbitrators to impose punishments, "this should not be done in an arbitration setting." (App. 12.)

Judge Beam believed the arbitral award of punitive damages violated Chica's due process rights under Pacific Mut. Life Ins. Co. v. Haslip, 111 S.Ct. 1032 (1991). "In the arbitration setting we have almost none of the protections that fundamental fairness and due process require for the imposition of this form of punishment." (App. 12, Beam dissenting.) Discovery is

abbreviated if available at all. Id. The rules of evidence are employed, if at all, in a very relaxed manner. Id. Arbitrators in private court systems act with almost none of the safeguards of the public courts. Id.

Judge Beam also questioned whether confirmation of the award in the absence of any meaningful judicial review complied with the due process requirements established in Haslip. In Haslip, the Court upheld a jury's punitive damage award against a due process challenge, emphasizing that necessary review by the trial and appellate courts under Alabama statutes provided a check on arbitrary decision making. 111 S.Ct. at 1043-46.

In contrast to the Alabama procedure in Haslip, Judge Beam noted "the scope of review of the arbitrator's award is narrowly limited if not almost nonexistent." (App. 12). He noted "This standard of review, of course, almost completely ignores the review required by Haslip." (App. 13).

Chica petitioned the Eighth Circuit for rehearing and rehearing en banc on January 26, 1993. Chica's petition specifically sought rehearing so the panel could consider the due process implications of its punitive damage ruling.

The Securities Industry Association, Inc. ("SIA"), which represents over 650 broker-dealers in the United States and Canada, sought and obtained leave to file a petition for rehearing en banc as amicus on the issue of the constitutionality of punitive damages in arbitration. (App. 14).

Chica's petition for rehearing and rehearing en banc was denied by a five to six vote on March 4, 1993 (App. 15).

REASONS FOR GRANTING THE WRIT

This case presents the issue of whether arbitrators in a private court system, in this case the AAA, have the power to impose the punishment of punitive damages, a function that historically has been the exclusive province of the state subject to its strict regulation. "The authority of arbitrators to grant relief in the nature of punitive damages is a fiercely debated policy issue confronting both students of the arbitral process and parties to arbitration." Stipanowich, Punitive Damages in Arbitration - Garrity v. Lyle Stuart, Inc. Reconsidered, 66 B.U.L. Rev. 953, 955 (1986).

The lower courts take widely divergent approaches on the question of whether arbitrators have the power to inflict the punishment of punitive damages. Kupperman & Freedman, Selected Topics In Securities Arbitration: Rule 15c2-2, Fraud, Duress, Unconscionability, Waiver, Class Arbitration, Punitive Damages, and Attorneys Fees and Costs, 65 Tul. L. Rev. 1547, 1593 (1991). Some hold that arbitrators lack the power to impose punitive damages, even by agreement. Id. Others hold that punitive damages may be awarded in arbitration only if the arbitration agreement specifically and explicitly so provides. Id. Still others hold that arbitrators may award punitive damages whenever the arbitration agreement can reasonably be construed to permit the award. Id.

The issues have a wide ranging impact on the powers of private court systems and the relationship between the governmental court systems and the private courts. In recent years, large segments of the business community have, by contract, removed from the public courts the power to adjudicate disputes. In 1987 and 1989, this Court reversed precedent prohibiting the enforcement of predispute arbitration agreements for claims arising under the federal securities laws.[2] Since

that time, thousands of securities disputes have been decided in various arbitral fora. The number of securities cases submitted to arbitration each year has increased by more than 250% since 1987, and a similar increase has occurred in commercial arbitration since 1972. Pierce, The Federal Arbitration Act: Conflicting Interpretation of its Scope, 61 Cin. L. Rev. 623, 623 (1992).

Whether arbitrators should have the power to punish by punitive damages is of intense interest to the securities industry. In light of "the incredible potential for harm that awards of punitive damages engender. . . . the securities industry may suffer a tremendous setback if arbitrators are given the power to award punitive damages." Sabino, Awarding Punitive Damages in Securities Arbitration: Working for a Just Result, 27 U. Rich. L. Rev. 33, 68 (Fall 1992). The SIA's intervention as an amicus seeking rehearing en banc of the panel decision confirms the importance of this case to the securities industry.

At least 174 punitive damage arbitration awards totaling $29,489,900 were issued in securities arbitrations from May 1989 through June 1992. Punitive Award Survey, Vol. 4, No. 7 Securities Arbitration Commentator 1, 4 (May 1993). The General Accounting Office reports that arbitrators in industry sponsored arbitral fora awarded punitive damages in 12% of the cases where such damages were requested, and AAA arbitrators in 9% of the cases where such damages were requested. Securities Arbitration--How Investors Fare, GAO Report to Congressional Requesters, May 11, 1992 (GAO/GGD-92-74).

This petition also presents the question of whether due process is violated by judicial enforcement of a

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[2] See Rodriguez de Quijas v. Shearson/American Exp., Inc., 490 U.S. 477 (1989); Shearson/American Express v. McMahon, 482 U.S. 220 (1987).

punitive arbitral award issued against a person who is not a party to the arbitration agreement. The lack of meaningful safeguards in the informal arbitration process, coupled with the extremely limited judicial review afforded by the Eighth Circuit, deprived Chica of the protections this Court has deemed important in upholding jury awarded punitive damages. See Pacific Mut. Life Ins. Co. v. Haslip, 111 S.Ct. 1032, 1043-45 (1991).

The decision below is an unprecedented and unconstitutional expansion of the power of private courts. It allows private court systems to assert jurisdiction over, and then to punish, persons who have not agreed to give them that power. It not only grants private courts essentially unreviewable discretion to determine who is subject to their jurisdiction, but also allows them to exercise the traditional governmental power of imposing punishments, while providing no meaningful judicial review.

This Court should review the Eighth Circuit's decision enforcing a punitive damage arbitration award against a person who is not a party to the arbitration agreement. The decision below contravenes decisions of this Court and numerous other courts, violates Due Process, and grants to private arbitrators a power--the power to punish--which the State of Minnesota, has reserved to itself. This petition for a writ of certiorari should be granted.

A.

THE EIGHTH CIRCUIT'S RULING IN THIS CASE CONFLICTS WITH PERRY v. THOMAS AND THE DECISIONS OF NUMEROUS OTHER COURTS.

Section 2 of the FAA provides that written contracts to arbitrate, "shall be valid, irrevocable, and

enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract. 9 U.S.C. § 2. In Perry v. Thomas, 482 U.S. 483 (1987), this Court ruled that under Section 2 general state contract law must be applied in determining the enforceability of arbitration agreements:

> Thus state law, whether of legislative or judicial origin, is applicable if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally. . . . A court may not, then, in assessing the rights of litigants to enforce an arbitration agreement, construe that agreement in a manner different from that in which it otherwise construes non-arbitration agreements under state law.

482 U.S. at 492-93 n.9 (1987). The Eighth Circuit flatly refused to apply general Minnesota contract law to determine whether Chica was bound to arbitrate under the customer agreement to which he was not a party. Rather than follow Perry's instruction to apply general state contract law principles, the Eighth Circuit said:

> Arbitrability of contracts evidencing interstate commerce is governed by federal substantive law rather than state law.

(App. 6.)

The Eighth Circuit, erroneously believing federal law applied, refused to apply Minnesota law which provides that, "Where an agent, acting for a disclosed principal, enters into a contract with third persons for and on account of his principal and in his name, the contract is that of the principal and does not give rise to any contractual obligation running to the agent." Kost v.

Peterson, 292 Minn. 46, 49, 193 N.W.2d 291, 294 (Minn. 1971). It is undisputed that Chica acted as an agent for a disclosed principal, his employer Engler-Budd, and that the customer agreement is a contract between Engler-Budd and Lee. "[T]he contract is that of the principal [Engler-Budd] and does not give rise to any contractual obligation running to the agent [Chica]." Id.[3]

By ruling that under federal law Chica was bound to arbitrate under an agreement to which he was not a party under general state contract law, the Eighth Circuit did precisely what this Court said it could not do--it "construe[d] that agreement in a manner different from that in which it otherwise construes non-arbitration agreements under state law." Perry, 482 U.S. at 492-493 n.9. This ruling also directly conflicts with this Court's longstanding directive that the FAA be construed "to make arbitration agreements as enforceable as other contracts, but not more so." Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 404 n.12 (1967). The ruling makes arbitration agreements enforceable where ordinary contracts are not, and unlawfully "elevates [arbitration agreements] over other forms of contract." Id. at 404 n.12.

"[T]he FAA does not require parties to arbitrate when they have not agreed to do so." Volt Information Sciences v. Board of Trustees, 489 U.S. 468, 478 (1989). Yet, this is precisely what the Eighth Circuit required Chica to do here. It held Chica to the arbitration award even though he had not agreed to arbitrate as a matter of general state contract law.

The Eighth Circuit's refusal to apply general state contract law in determining arbitrability conflicts not

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[3] The Minnesota rule that an agent is not bound by the contracts of the principal is widely, if not universally, accepted. See Restatement (Second) of Agency § 320 (1958) ("Unless otherwise agreed, a person making or purporting to make a contract with another as agent for a disclosed principal does not become a party to the contract.").

only with Perry and Volt, but also with its own decisions and those of numerous other courts. See, e.g., Recold, S.A. de C.V. v. Monfort of Colorado, Inc., 893 F.2d 195, 197 n.6 (8th Cir. 1990) ("In addressing the issue of whether a party has entered into an agreement to arbitrate under the Arbitration Act, courts are to apply general state law principles . . ."); Supak & Sons Mfg. Co., Inc. v. Pervel Industries, Inc., 593 F.2d 135, 137 (4th Cir. 1979) ("Section 2 [of the FAA] . . . does not displace state law on the general principles governing formation of the contract itself."); Ziegler v. Whale Securities Co., L.P., 786 F.Supp 739, 741-2 (N.D. Ind. 1992) ("In order to determine whether a valid arbitration agreement exists, this Court must turn to state contract law."); Cook Chocolate Co. Salomon, Inc., 684 F.Supp. 1177, 1182 (S.D.N.Y. 1988) ("At the same time, however, § 2 of the Act preserves general principles of state contract law as rules of decision on whether the parties have entered into an agreement to arbitrate."); Duplan Corp. v. W.B. Davis Hosiery Mills, Inc., 442 F.Supp. 86, 87-88 (S.D.N.Y. 1977) ("Congress intended only to place arbitration agreements affecting commerce or maritime affairs on the same footing as other contracts, but not to create a federal law of contract formation.").

The Eighth Circuit attempted to distinguish Perry by saying:

> In Perry the specific issue was whether the parties could be compelled to arbitrate according to the contract provisions. In contrast, the present case is an action seeking to confirm an award already made by an arbitration panel in accordance with a provision in a contract.

(App. 6.) This was plainly wrong. Section 9 of the FAA, which governs judicial confirmation of arbitration awards, permits confirmation of an award only "[i]f the parties in their agreement" provide that a judgment may

be entered on the award. 9 U.S.C. § 9 (emphasis added). Chica was not a party to the arbitration contract. The distinction made by the Eighth Circuit is also illogical. The power of an arbitration panel does not change depending on when the issue is raised. The power of an arbitration panel arises from the agreement of the parties. That agreement remains the same whether the issue is raised by a motion to compel arbitration or a motion to vacate an arbitration award.

The Eighth Circuit is developing a general federal common law of contracts to govern arbitration agreements, rather than applying general state contract law as required by Perry. This is not the proper role for the federal courts. It unlawfully preempts long settled contract law developed by the states. The Eighth Circuit's complete federalization of arbitration law is directly contrary to Perry, and should be reversed.

B.

THE EIGHTH CIRCUIT'S RULING THAT THE FEDERAL ARBITRATION ACT PREEMPTS A STATE LAW RESERVING TO THE STATE THE POWER TO PUNISH BY PUNITIVE DAMAGES CONFLICTS WITH THE DECISIONS OF THE SECOND CIRCUIT AND NUMEROUS OTHER COURTS.

Even if Chica was somehow bound by the agreement to arbitrate, the punitive award should have been vacated because it was excluded from the scope of the agreement. The customer agreement provides that, "If any controversy arises out of this agreement, it shall be determined by arbitration, except where prohibited by law." (App. 3). The agreement chose the law to determine whether a claim is arbitrable--"This agreement

and its enforcement shall be governed by the laws of the State of Minnesota." Id. Minnesota law prohibits the arbitral award of punitive damages. Punitive damages were, therefore, outside the scope of the arbitration agreement.

A. Minnesota Law Prohibits Punitive Arbitral Awards.

Many states, including Minnesota, do not permit private arbitrators to inflict the punishment of punitive damages, even by agreement. These states reserve to the government, through the courts, the power to punish. The public policy prohibiting anyone other than the state from awarding punitive damages is explained in the leading case of Garrity v. Lyle Stuart, Inc., 40 N.Y.2d 354, 353 N.E.2d 793 (N.Y. Ct. App. 1976). In Garrity, the court vacated a punitive arbitration award on the grounds that only the state, and not arbitrators, can award punitive damages. 353 N.E.2d at 795. The court ruled that "[p]unitive sanctions are reserved to the State," 353 N.E.2d at 796, and this power cannot be delegated to arbitrators, even by agreement:

> The law does not and should not permit private persons to submit themselves to punitive sanctions of the order reserved to the State. The freedom of contract does not embrace the freedom to punish, even by contract.

353 N.E.2d at 797.

The district court here concluded that Minnesota law prohibited the arbitral award of punitive damages. (App. 4.)[4] Minnesota statutes permit the award of punitive damages only in court proceedings where this punishment can be monitored and controlled. In Minnesota punitive damages are available only in "civil actions." Minn. Stat. § 549.20 subd. 1 (1990). Civil "actions" in Minnesota are judicial proceedings before a court of law, and do not include arbitration. In a similar case, the Minnesota Supreme Court ruled that a statute allowing prejudgment interest in an "action" could not be used to support a prejudgment interest award in an arbitration proceeding. Lucas v. American Family Mut. Ins. Co., 403 N.W.2d 646, 649-51 (Minn. 1987). In Lucas, the Court ruled that the word "action" in the prejudgment interest statute does not include arbitration proceedings. 403 N.W.2d at 650. An arbitration proceeding is not a "civil action" in which punitive damages may be awarded.

Minnesota law also provides that punitive damages may not be sought in a complaint until a "court" determines that a plaintiff has made a prima facie case of entitlement to punitive damages by showing a factual basis for the claim. Minn. Stat. § 549.191 (1990). In addition, Minn. Stat. § 549.20 subd. 5 (1990), specifically refers to "the court" and "judicial review," and requires the trial "court" to review punitive damage awards and make specific findings with respect to them.[5] Subdivision

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[4] In addition to New York and Minnesota, courts in New Mexico and Indiana have also expressly ruled that arbitrators may not award punitive damages. See Shaw v. Kuhnel & Associates, Inc., 698 P.2d 880, 882 (N.M. 1985); United States Fidelity & Guar. v. DeFluiter, 456 N.E.2d 429, 432 (Ind. App. 1983). Colorado prohibits punitive arbitral awards by statute. Colo. Stat. Ann. § 13-21-102(5).

[5] Although this subdivision applies only to causes of action arising on or after May 4, 1990, it confirms the legislative determination that punitive damages be available only in "court" proceedings, and not in arbitrations.

5 also requires the "appellate court" to review the award in light of the statutory standards for punitive damage awards. Minnesota restricts punitive awards to court proceedings because, "Punitive damages are imposed for the public purposes of punishment and deterrence." Kociemba v. G.D. Searle & Co., 707 F.Supp. 1517, 1539 n.22 (D. Minn. 1989) (emphasis in original).

B. The Eighth Circuit's Ruling Conflicts with the Decisions of the Second Circuit and Other Courts.

Where an arbitration agreement provides it is to be governed by the law of a particular state, that state law governs and punitive arbitral awards prohibited by state law will not be enforced. This is the rule adopted by the Second Circuit. Barbier v. Shearson Lehman Hutton, Inc., 948 F.2d 117, 122 (2d Cir. 1991). In Barbier, the Court vacated a punitive damage arbitration award where the arbitration agreement contained a New York choice-of-law provision. Barbier held that by selecting New York law, which prohibits the arbitral award of punitive damages, the parties intended to be bound by the state law limitation on punitive awards. 948. F.2d at 122. The Second Circuit could conceive of "no clearer example of a case" where arbitrators exceeded their powers under 9 U.S.C. §10(a)(4), stating:

> "[T]here is no clearer example of a case falling neatly within that provision than the case at bar. Since the arbitrators were not entitled to award punitive damages due to the choice-of-law provision in the parties' Agreement, it is manifest that the Panel exceeded its authority in awarding punitive damages. That portion of the award should have been vacated by the district court pursuant to 9 U.S.C. § 10(a)(4)."

948 F.2d at 122. The Eighth Circuit's decision here directly conflicts with Barbier. The Eighth Circuit refused to vacate the punitive arbitral award, and refused to enforce the choice-of-law provision which limited the arbitrators' powers.

Indeed, prior to the ruling in this case, the Seventh and Eighth Circuits, as well as several federal district courts, had also ruled that state law prohibiting punitive arbitral awards applied by virtue of choice-of-law clauses in arbitration agreements. See Surman v. Merrill Lynch, Pierce, Fenners & Smith, 733 F.2d 59, 63 (8th Cir. 1984) ("Appellees argue that if their fraud claims are referred to arbitration, they will not be able to recover punitive arbitral damages. This, however, is what the parties contracted for."); Pierson v. Dean, Witter, Reynolds, Inc., 742 F.2d 334, 336 n.2, 337-339 (7th Cir. 1984) (By agreeing to AAA arbitration under New York law, plaintiffs waived right to obtain punitive damages which are not available in arbitration under New York law); Waltman v. Fahnestock & Co., Inc., 792 F.Supp. 31, 32 (E.D. PA 1992) ("Essentially, Judge Leisure and the Second Circuit held that New York law governed the arbitration and that New York law prohibited arbitrators from awarding punitive damages."); Shahmirzadi v. Smith Barney, Harris ,Upham & Co.; 636 F.Supp. 49, 56 (D. D.C. 1985) ("When the plaintiffs executed the Customer's Agreement, they contractually waived their right to punitive damages by agreeing to be governed by arbitration and New York law"); Baselski v. Paine, Webber, Jackson & Curtis, Inc., 514 F.Supp. 535, 543 (N.D. Ill. 1981) ("The parties have agreed in their 'Customer's Agreement' that their contractual relationship will be governed by the law of the State of New York. Thus, the plaintiffs have contractually 'waived' their right to punitive damages").

The majority panel ruled that, regardless of Minnesota law, federal law gave effect to AAA rules it

believed permitted arbitrators to award punitive damages. The panel ruled that "This case is governed by federal law. . . . [and] the FAA gives force to the rules of the AAA." (App. 9-10.) This ruling was wrong. Federal law gives effect to the parties' choice of Minnesota law. And, the AAA rules themselves required the arbitrators to abide by Minnesota law prohibiting arbitrators from awarding punitive damages. AAA Rule 43 allows arbitrators to "grant any remedy or relief the arbitrator deems just and equitable," as long as the relief is "within the scope of the agreement of the parties." (App. 11). The parties' agreement here excluded certain claims from arbitration--i.e. controversies where arbitration was "prohibited by [Minnesota] law." Arbitration of punitive claims is prohibited by Minnesota law. This agreement should have been enforced. "Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit." Volt Information Sciences v. Board of Trustees, 489 U.S. 468, 479 (1989).

In Volt, this Court held the FAA required enforcement of the parties' choice of California law, even though that law resulted in a stay of arbitration pending resolution of related litigation. The Eighth Circuit's refusal to enforce the choice-of-law provision here directly conflicts with Volt's ruling that, "[t]he FAA does not . . . prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement." Id. at 478.

The Eighth Circuit's wholesale preemption of state law, in derogation of the arbitration agreement, was not justified. "[T]he FAA contains no express preemptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration." Volt, 489 U.S. at 477. State law applies in arbitration matters, subject to preemption only "to the extent that it actually conflicts with federal law." Volt, 489 U.S. at 477. There is no

actual conflict between the FAA and the state law rule reserving to the state the power to punish by punitive damages. The state's decision to reserve to itself the power to punish can peacefully co-exist with federal law favoring arbitration.[6]

Congress did not intend that the FAA invalidate Minnesota state law reserving to the state the power to punish by punitive damages. The federal policy favoring arbitration is strong. But, "That is not to say that all controversies implicating statutory rights are suitable for arbitration." Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, 473 U.S. 614, 627 (1985). Statutory claims resting on the state's power to punish, such as the punitive claim here, are not suitable for arbitration. This is especially true because the power to punish is an important aspect of a state's sovereignty. "The right to formulate and enforce penal sanctions is an important aspect of the sovereignty retained by the States." Kelly v. Robinson, 479 U.S. 36, 47 (1986). Congress did not intend to force the states to relinquish to private arbitrators the sovereign power to punish.

There is a split in the circuits, and some courts would rule as the Eighth Circuit did. See Todd Shipyards Corp. v. Cunard Line, Ltd., 943 F.2d 1056 (9th Cir. 1991); Raytheon Co. v. Automated Business Systems, Inc., 882 F.2d 6, 7 (1st Cir. 1989); Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378, 1386 (11th Cir. 1988).

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[6] The state's decision to limit punitive awards to court proceedings is not a law directed against arbitration in particular. Any agreement by a person to submit to punishment by a private person or group would be invalid in Minnesota. For example, under general Minnesota contract law, and the UCC adopted in most states, parties may not legally agree to liquidated damages clauses that act to penalize the breaching party. Minn. Stat. § 336.2-718(1) (1990) (". . . A [contract] term fixing unreasonably large liquidated damages is void as a penalty."). Punishment by private persons is not permitted in Minnesota, whether it flows from an arbitration award or some other contractual arrangement.

The decisions relied upon by the Eighth Circuit here, such as Raytheon, supra, have been soundly criticized for overextending arbitral authority. Note, Overextension of Arbitral Authority: Punitive Damages and the Issue of Arbitrability, 65 Wash. L. Rev. 678 (1990). All these decisions proceed on the mistaken notion that arbitrability is exclusively a matter of federal law. None of the cases consider the direction in Perry v. Thomas, 482 U.S. 483, 492-93 n.9 (1987), that the courts must apply general state contract law in interpreting arbitration agreements.

C.

THE EIGHTH CIRCUIT'S RULING VIOLATES DUE PROCESS BY ALLOWING ARBITRATORS TO IMPOSE PUNITIVE DAMAGES IN INFORMAL PROCEEDINGS WHILE PROVIDING NO MEANINGFUL JUDICIAL REVIEW.

The court's enforcement of the punishment of punitive damages against Chica violates due process. U.S. Const. amend. V. Punitive damages are not to be "reached in proceedings lacking the basic elements of fundamental fairness." Pacific Mut. Life Ins. Co. v. Haslip, 111 S.Ct. 1032, 1038 (1991), quoting Browing-Ferris Industries of Vermont, Inc. v. Kelco Disposal, Inc., 492 U.S. 257, 276 (1989). "In the arbitration setting we have almost none of the protections that fundamental fairness and due process require for the imposition of this form of punishment." (App. 12, Beam dissenting.) Indeed, the very nature of the arbitral process exposes participants to the potential loss of valuable constitutional rights. "At present, arbitration operates in a culture where, as a matter of doctrine, no definite legal norms safeguard constitutional

rights." Brunet, Arbitration And Constitutional Rights, 71 N.C.L. Rev. 81, 117 (1992).

Chica had none of the due process protections this Court found adequate in Haslip, 111 S.Ct. at 1043-46. In Haslip, this Court upheld a due process challenge to an Alabama jury's award of punitive damages. This Court emphasized that the three layers of safeguards provided by Alabama's scheme for imposing punitive damages were essential to its decision upholding the punitive award. Under Alabama's system, these safeguards were provided through 1) jury instructions to guide the jury's discretion, 2) post-trial review conducted by the trial court, applying specific criteria, and 3) appellate review, also applying specific criteria. Id. at 1044-46.[7] The procedures approved in Haslip "ensure[d] meaningful and adequate review by the trial court whenever a jury has fixed the punitive damages," 111 S.Ct. at 1044, and appellate application of "detailed substantive standards" for punitive damages "provide[d] an additional check on the jury's or trial court's discretion." Id. at 1045.

None of the three layers of protection available in Haslip, and guaranteed by Minnesota statutes in judicial proceedings, were provided to Chica here. There were no instructions on the law to guide to the arbitrators. Instead, in Minnesota "arbitrators may do what no other person acting in the capacity of one who judges can or has a right to do, namely they may intentionally decide

[7] These protections, and more, are provided in court proceedings where punitive damages are imposed in Minnesota. In judicial proceedings, a punitive claim cannot be asserted in a pleading until a prima facie showing of entitlement to them has been made to, and determined sufficient by, a court. Minn. Stat. § 549.191 (1990). The trial court must review any punitive award in light of statutorily defined standards, and must make specific findings with respect to them. Minn. Stat. § 549.20 subd. 5 (1990). Appellate courts are likewise required to evaluate the award in light of statutory factors. Id.

contrary to the law and still have their judgment stand." Zelle v. Chicago & Northwestern Ry Co., 242 Minn. 439, 447, 65 N.W.2d 583, 589 (Minn. 1954). Enforcement of a punitive arbitration award against a person who never agreed to give the arbitrators jurisdiction itself violates due process.

No meaningful judicial review was provided here. Instead, the Eighth Circuit ruled the award "is subject only to very limited scrutiny," and could not be set aside "unless it is completely irrational or evidences a 'manifest disregard for law.'" (App. 5, 10.) As the dissent noted, "This standard of review, of course, almost completely ignores the review required by Haslip." (Beam dissenting, App. 13). The narrow, if not almost non-existent, review provided by the Eighth Circuit is incompatible with the due process required review approved in Haslip.

The constitutionally required meaningful judicial review of the punitive arbitration award was virtually impossible. The AAA maintained no record of the testimony presented at the arbitration proceeding. "An arbitral award can be made without explication of the reasons and without development of a record, so that the arbitrator's conception of our statutory requirement may be absolutely incorrect yet functionally unreviewable, even when the arbitrator seeks to apply our law." Scherk v. Alterto-Culver Co., 417 U.S. 506, 532 (1974)(Douglas, J., dissenting).

In upholding the constitutionality of punitive damage awards by juries, this Court also relied upon the long history of the practice of allowing juries to assess such punishment. Haslip, 111 S.Ct. at 1042-43, and at 1051-54 (Scalia, J. concurring). In contrast to jury awarded punitive damages, no great historical tradition supports the arbitral award of punitive damages.

Chica never "had the benefit of the full panoply of [Minnesota's] procedural protection." Haslip, 111 S.Ct. at

1046. The judicial enforcement of the punitive arbitration award violates Chica's due process rights.

CONCLUSION

This petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: May 28, 1993

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APPENDIX

Appendix A - Opinion of the United States Court of Appeals for the Eighth Circuit, January 12, 1993. . . . A-1

Appendix B - Order of the United States Court of Appeals for the Eighth Circuit, February 4, 1993, Granting the Securities Industry Association, Inc.'s Motion for Leave to File Petition for Rehearing En Banc as Amicus Curiae A-14

Appendix C - Order of the United States Court of Appeals for the Eighth Circuit, March 4, 1993, Denying Petition for Rehearing and Rehearing En Banc A-15

Appendix D - Oral Ruling of the United States District Court for the District of Minnesota, August 16, 1991 . . . . . A-18

Appendix E - Order of the United States District Court for the District of Minnesota, August 22, 1991 . . . . . A-19

Appendix F - Award of Arbitrators, March 20, 1991 . . . . . A-21

Appendix G - Minnesota Punitive Damage Statutes - Minn. Stat. §§ 549.191 (1990) and 549.20 (1990). . . .A-24

APPENDIX A

United States Court of Appeals

FOR THE EIGHTH CIRCUIT

Nos. 91-3043/3146

In the Matter of Arbitration Between: Judy Lee, *Appellant / Cross-appellee*,	* Appeals from the * United States District * Court for the * District of Minnesota
v.	
James John Chica; Engler-Budd & Co., Inc., *Appellees / Cross-appellants*,	*

Submitted: May 15, 1992

Filed: January 12, 1993

Before McMILLIAN, JOHN R. GIBSON and BEAM, Circuit Judges.

McMILLIAN, Circuit Judge.

Judy Lee appeals from a final order entered in theDistrict Court[1] for the District of Minnesota to the extent that it vacates the punitive damages awarded by an arbitration panel. Lee v. Chica, No. 3-91-304 (D. Minn. Aug. 22,1991) (order). For reversal, Lee argues the district court erred in refusing to confirm the arbitration panel's award of punitive damages because (1) federal law governs the arbitrability of the dispute and (2) the arbitration clause in the Customer Agreement incorporated the rules of the American Arbitration Association (AAA) which allow arbitration panels to award punitive damages.

James John Chica cross-appeals from the district court's final order to the extent that it confirms the arbitration panel's award of compensatory damages and attorney's fees to Lee. For reversal, Chica argues the district court erred in holding that Lee's claims against him individually were subject to arbitration because he did not sign, and therefore was not a party to the customer agreement. Chica agrees that the district court was correct in denying Lee punitive damages.

For the reasons discussed below, we affirm that part of the district court's order confirming compensatory damages and attorney's fees and reverse that part of the district court's order denying Lee punitive damages.

I. Facts

In 1987 Lee opened a securities account with the now defunct Engler-Budd & Company, Inc. (Engler-Budd), a broker-dealer and member of the National Association of Securities Dealers (NASD). Chica, a NASD registered securities representative, was Lee's original and sole account representative for the entire time Lee had an acccunt at Engler-Budd.

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[1]The Honorable Robert G. Renner, United States District Judge for the District of Minnesota.

Lee signed a Customer Agreement at the request of Chica when she opened the account. Paragraph 15 of the Customer Agreement contained the following arbitration clause:

> This agreement and its enforcement shall be governed by the laws of the State of Minnesota. If any controversy arises out of this agreement, it shall be determined by arbitration, except where prohibited by law. Such arbitration shall be in accordance with the rules, then obtaining, of the American Arbitration Association. I authorize you, if I do not make such election . . ., to make such election in my behalf. Any arbitration hereunder shall be before at least three arbitrators and judgment upon the award rendered by the arbitrators or a majority of them may be entered in any court, state or federal, having jurisdiction.

Lee is the only signatory of the Customer Agreement.

A dispute arose concerning the management of the account. In July of 1990, Lee filed a demand for arbitration with the AAA against Engler-Budd and Chica. Lee alleged that Engler-Budd and Chica had violated the Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b); the Securities Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5; the Securities Act of 1993, 15 U.S.C. § 77a-78; and the Minnesota Securities Act, Minn. Stat. § 80A; and also alleged state common law claims of negligence, fraud and breach of fiduciary duty. Lee claimed that Engler-Budd and Chica opened a margin account in her name without informing her of the risks and that Engler-Budd and Chica bought and sold securities in this account without her authorization and failed to follow specific sell orders given by her.

Neither Engler-Budd[2] nor Chica answered the demand for AAA arbitration. Chica made no appearance at the arbitration hearings, did not answer the AAA complaint, nor did he sign the AAA arbitration submission agreement. In December of 1990, the arbitration panel held a hearing on the dispute and awarded Lee $10,600 in compensatory damages, $5,000 in attorney's fees and $31,800 in punitive damages against both Engler-Budd and Chica.

On June 7, 1991, Lee filed an application and motion in federal district court to confirm the arbitration award. Chica filed a cross-motion to vacate or modify the award. The district court confirmed the arbitration award of compensatory damages and attorney's fees, but vacated the award of punitive damages. The district court accepted the argument by Chica that Minnesota law prohibited an award of punitive damages by an arbitration panel. The district court noted that the arbitration clause in the customer agreement had incorporated Minnesota state law as the law to govern the contract. Therefore, the district court reasoned that the parties had intended to limit the scope of recovery in the event of a breach of contract to that which would be allowed by Minnesota law, which, in the view of the district court did not include punitive damages. This appeal and cross-appeal followed.

II. Arbitration

The issues in this appeal involve whether federal or state law applies in interpreting the arbitration clause in the customer agreement and in determining if arbitrators can award punitive damages. Lee argues that the Federal Arbitration Act (FAA), 9 U.S.C. §§ 1-14, applies in this case because there is federal subject

[2]Engler-Budd is not a party in this appeal and did not participate in the district court proceedings concerning this matter. Because Engler-Budd is not involved in this dispute, it is not necessary to determine Engler-Budd's liability.

matter jurisdiction and that the FAA specifically applies in cases involving interstate commerce. Chica contends that State law applies because courts are to use state law to interpret the arbitration clause in the contract and to determine the ability of arbitrators to award punitive damages. Each party contends that if the district court applied the law he or she contends is the proper law to apply, it will result in a decision that is favorable to him or her.

A. Scope of Review of Arbitrators' Awards

It is well-settled that judicial review of arbitration awards is narrowly limited and that an arbitration award will not be set aside unless it is completely irrational or evidences a "manifest disregard for law." E.g., Barbier v. Shearson Lehman Hutton, Inc., 948 F.2d 117, 120 (2d Cir. 1991) (Barbier); Todd Shipyards Corp. v. Cunard Line, Ltd., 943 F.2d 1056, 1060 (9th Cir. 1991) (Todd Shipyards); General Tel. Co. v. Communications Workers of America, 648 F.2d 452, 457 (6th Cir. 1981) (Communications Workers) ("Reviewing courts should be extremely reluctant to substitute their interpretation of the agreement for that of the arbitrator.").

B. Arbitration of Claims Against Chica

The initial question raised is whether the law of Minnesota, governs the arbitrability of this case. Chica argues that he should not be a party to this action because he did not sign the customer agreement and Minnesota law would not enforce the terms of a contract between Lee and Engler-Budd against Chica. Kost v. Peterson, 292 Minn. 46, 193 N.W.2d 291 (1971). Chica relies on Perry v. Thomas, 482 U.S. 483 (1987) (Perry), to argue that the contract is not enforceable against him. The Supreme Court in Perry stated in a footnote that when this type of "standing" issue presents itself, courts, in determining whether to apply state or federal law, are

to apply state law "if that law arose to govern issues concerning validity, revocability, and enforceability of contracts generally." Id. at 492 n.9 (emphasis in original). Furthermore, the Supreme Court stated that courts are to examine arbitration agreements in the same light they would examine any other contractual agreement. Id.

Perry involved a dispute over the amount of commissions due on the sale of securities between a former employee and his former employer and two of its employees. The former employee argued that his dispute could be heard by the California courts under the California Labor Code,[3] while the two employees argued that according to the employment contract the dispute had to be heard by an arbitration panel. The former employee argued that the two employees were not parties to the agreement, and therefore lacked "standing" to force him to arbitrate the dispute. Id. at 488.

While Chica relies on Perry for support, his argument is misplaced. In Perry, the specific issue was whether the parties could be compelled to arbitrate according to the contract provisions. In contrast, the present case is an action seeking to confirm an award already made by an arbitration panel in accordance with a provision in a contract. It is not an issue of validity, revocability or enforceability of the arbitration agreement within the contract.

Arbitrability of contracts evidencing interstate commerce is governed by federal substantive law rather than state law. Southland Corp. v. Keating, 465 U.S. 1, 15-16 (1984) (Keating); Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983) (Cone); Prima Paint v. Flood & Conklin Mfg. Co., 388 U.S. 395, 402-05 (1967) (Prima Paint); Letizia v. Prudential Bache Secur., Inc., 802 F.2d 1185, 1187 (9th Cir. 1986) (Letizia);

[3]Cal. La. Code § 229 (West 1971) (actions for wages can be maintained in courts without regard to private arbitration agreements).

Bayma v. Smith Barney, Harris Upham & Co., 784 F.2d 1023, 1025 (9th Cir. 1986); see also I.S. Joseph Co. v. Michigan Sugar Co., 803 F.2d 396, 399 n.2 (8th Cir. 1986).[4]

Federal courts have found that an arbitration agreement between a customer and a brokerage firm can also be binding on the agent who represented or traded in the customer's account even if the agent had not signed the customer agreement. Letizia, 802 F.2d at 1188 (nonsignatory employees of brokerage firm are bound by the customer agreement between brokerage firm and customer); Scher v. Bear Sterns & Co., 723 F.Supp. 211, 216 (S.D.N.Y. 1989) ("Acts by employees of one of the parties to a customer agreement are equally arbitrable as acts of the principals as long as the challenged acts fall within the scope of the customer agreement."); Brener v. Becker Paribas, Inc., 628 F.Supp. 442, 451 (S.D.N.Y. 1985) (arbitration clause that called for arbitration of any disputes arising out of the customers' accounts was broad enough to include the agent who actually did the transactions); see also Nesslage v. York Secur., Inc., 823 F.2d 231, 233 (8th Cir. 1987) (disclosed agents of the broker could enforce an arbitration agreement between the broker and the customer).[5]

[4]In I.S. Joseph Co. v. Michigan Sugar Co., 803 F.2d 396, 399 n.2 (8th Cir. 1986), the court noted that an arbitration agreement could be drafted broadly enough so as to give the arbitrator the right to determine arbitrability. The contract provision in this case is an example of such a broad contract provision. Paragraph 15 of the Customer Agreement provides that arbitration is to be used to resolve "any controversy aris[ing] out of th[e] agreement." It also authorizes the signing party to elect arbitration even if the principal or in this case even if the agent refuses to. Contrast this with the arbitration clause that was considered too narrow to vest arbitrators with the ability to determine arbitrability in the first instance in Necchi S.P.A. v Necchi Sewing Mach. Sales Corp., 348 F.2d 693, 695-96 (2d Cir. 1965), cert. denied, 383 U.S. 909 (1966).

[5]We note that there is dicta in Flink v. Carlson, 856 F.2d 44, 46 (8th Cir. 1988), which supports Chica's argument that, as an agent for a disclosed principal, he cannot be bound personally by the customer agreement. However, we think the holdings in that case and the present case are distinguishable. In Flink v. Carlson, the customer had signed two customer

In addition, the plain language of the arbitration clause reveals that Lee's claims against Chica are subject to arbitration even though Chica did not sign the customer agreement. The arbitration clause provides that "any controversy aris[ing] out of [the customer] agreement" will be settled by arbitration. It is not disputed that Chica was employed by Engler-Budd, that Lee knew of the employment relationship between Chica and Engler-Budd, and that Chica was responsible for the transactions in Lee's account. All of Lee's allegations against Chica arise out of his actions as Engler-Budd's employee in connection with the management of her account. Thus, we hold that Chica can be compelled to arbitrate Lee's claims against him as the disclosed agent of Engler-Budd, arising out of the customer agreement, even though he did not sign the customer agreement and we affirm the district court's order confirming the compensatory damages and attorney's fees.

III. Punitive Damages

Lee argues that the district court erred in vacating the punitive damages award. Lee argues that the customer agreement incorporated the rules of the AAA which allow arbitration panels to award punitive damages and that federal courts have upheld arbitral awards of punitive damages. Lee also contends that Minnesota does not have a clear rule or policy against

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agreements, one opening a margin account, the other a cash account; each contained an arbitration clause. The broker did not sign either customer agreement. There was a separate agreement between the brokerage firm and the individual broker in which the broker agreed to arbitrate any claims against him by a customer or the brokerage firm arising out of his employment. The customer initiated arbitration proceedings against both the brokerage firm and the broker. The brokerage firm asserted a cross-claim against the broker for indemnity or contribution. The customer then dismissed his claim against the broker from the arbitration. The court held that the brokerage firm could not compel the broker to arbitrate its third-party claim against him in the same arbitration proceeding involving the customer's claims against the brokerage firm. Id. at 47.

arbitrators' awarding punitive damages and that Chica's arguments are only speculations and conjectures about the real state of the law.

Chica argues that the district court correctly held that the arbitrators "exceeded their powers" under the FAA 9 U.S.C. § 10(a)(4), by awarding Lee punitive damages. Chica contends Minnesota law and public policy prohibit arbitrators from awarding punitive damages and that, by choosing Minnesota law in the contract, the arbitration panel and any court reviewing the arbitrators' decision must apply Minnesota law as it pertains to the awarding of punitive damages in arbitration. We disagree. The issue of which law to apply to the granting of punitive damages comes from the arbitration clause in the customer agreement which provides that enforcement "shall be governed by the laws of the State of Minnesota" and that "any controversy aris[ing] out of this agreement, . . . shall be determined by arbitration . . . in accordance with the rules, then obtaining, of the American Arbitration Association."

When the choice of law provision in an arbitral clause incorporates the rules of the AAA, some circuits have held, and we agree, that AAA arbitrators may grant any remedy or relief including punitive damages.[6] See Todd Shipyards, 943 F.2d at 1063, Raytheon Co. v. Automated Business Systems, Inc., 882 F.2d 6, 11-12 (1st Cir. 1989) (Raytheon); Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378, 1386-87 (11th Cir. 1988) (Bonar); Willoughby Roofing & Supply Co. v. Kajima Int'l, Inc., 598 F.Supp. 353,359 (N.D. Ala. 1984) (Willoughby), aff'd, 776 F.2d 269 (11th Cir. 1985).[7] Furthermore, there is

---

[6]AAA Rule 43 specifically allows arbitrators to award "any remedy or relief that the arbitrator deems just and equitable," including an award of punitive damages.

[7]Other courts have held that when an arbitration agreement clearly sets forth that a particular state law applies - and that state does not allow arbitrators to award punitive damages - arbitrators are not free to do so. However, the arbitration clause in those cases did not incorporate the rules of the AAA as in

nothing on the record that indicates that the arbitrators did not address the substantive law of Minnesota in *awarding punitive damages.*

Even if we accepted as valid Chica's argument that under state law the parties did not agree to arbitrate punitive damages because Minnesota law does not allow an awarding of punitive damages, it would not be dispositive in this case. This case is governed by federal law. See Raytheon, 882 F.2d at 11-12; Bonar, 835 F.2d at 1386-87; Willoughby, 776 F.2d at 264. When the parties, as here, agree to arbitration under the rules of AAA and the arbitration issues involve interstate commerce, the FAA gives force to the rules of the AAA. See Keating, 465 U.S. at 1; Cone, 460 U.S. at 1; Prima Paint, 388 U.S. at 395.

The Federal Arbitration Act states that an arbitrators award is to be confirmed unless the award can be "vacated, modified, or corrected as prescribed in sections 10 and 11" of the FAA. 9 U.S.C. §9. Section 10 provides that an arbitrators award can be overturned where the arbitration award was obtained by corruption, fraud, undue means, where there was evident partiality on the part of the arbitrators, where there was misconduct by the arbitrators[8], or where the arbitrators exceeded their power.[9] Id. Section 11 provides that an arbitrators award may be modified where there was an evident miscalculation of figures, or a material mistake in describing a person, thing or property referred to in the award, or where the arbitrators issued an award on a subject matter not submitted to them,[10] or where the

the present case. See New York Stock Exchange Arbitration between Fahnestock & Co. v. Waltman, 935 F.2d 512, 518 (2d Cir. 1991); Garrity v. Lyle Stuart, Inc., 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.3d 831 (1976).

[8]Misconduct includes a refusal to postpone arbitration hearings when there is sufficient cause shown to do such, or by refusing to hear evidence that is pertinent and material to the controversy, or any behavior that would result in prejudice to one of the parties. 9 U.S.C. § 10(a)(3).

[9]Chica argues that the arbitrators exceeded their power, see arguments supra.

[10]Chica argues that the arbitrator's award should be modified, because he

modification is to correct an imperfection in the matter or form which does not affect the merits of the controversy. Id. We see none of the abuses mentioned in sections 10 or 11 of the FAA to be evident in this case.[11]

The award of an arbitration panel is subject only to very limited scrutiny. Communications Workers, 648 F.2d at 457; Minute Maid Co. v. Citrus, Cannery, Food Processing, etc., 331 F.2d 280, 281 (5th Cir. 1964); accord Int'l Assn. of Machinists v. Cameron Iron Works, Inc., 292 F.2d 112, 119 (5th Cir.), cert. denied, 368 U.S. 926 (1961). Thus, we reverse that part of the district court order vacating the punitive damage award.

Accordingly, the judgment of the district court is affirmed in part and reversed in part and the case is remanded to the district court for further proceedings consistent with this opinion.

BEAM, concurring in part and dissenting in part.

I join the court in Parts I and II of its opinion. I disagree with the holding that the arbitration panel may award punitive damages. Accordingly, I dissent as to Part III.

Lee contends that AAA Rule 43, incorporated into the arbitration agreement by reference, allows the arbitrators to impose punitive damages. The majority agrees and states in footnote six that Rule 43 specifically allows punitive damages. I find no such authority in the words of Rule 43 and certainly no specific reference to punitive damages. The rule in its entirety says:

> The arbitrator may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement

---

claims that the subject of punitive damages should not have been submitted to them. See arguments supra.

[11] Minnesota has adopted the Uniform Arbitration Act (UAA). M.S.A. §§ 572.08 - 572.30 (1951). The UAA contains language similar to FAA Sections 10 and 11. Thus, our conclusions would be the same if we were to apply the UAA here - which we do not.

> of the parties, including, but not limited to, specific performance of a contract. The arbitrator shall, in the award, assess arbitration fees, expenses, and compensation as provided in Sections 48, 49, and 50 in favor of any party and, in the event that any administrative fees or expenses are due the AAA, in favor of AAA.

Thus, the arbitrator may award "any remedy" deemed "just and equitable." The arbitrator shall grant "compensation" as provided in section 48, 49 and 50. Rule 43 and sections 48, 49 and 50 say nothing about imposing punishment on a party to an arbitration agreement. Even if punishment could somehow be wedged into the "just and equitable" language, this should not be done in an arbitration setting.

Punitive damages are imposed not to compensate a plaintiff, but to be "'exemplary, punitive, or vindictive damages [imposed] upon a defendant.'" Pacific Mut. Life Ins. Co. v. Haslip, 111 S.Ct. 1032, 1042 (1991) (citing Day v. Woodworth, 13 How. 363, 371 (1852)). They are not to be "reached in proceedings lacking the basic elements of fundamental fairness." Id. at 1038. These elements are discussed at length in Haslip.

As stated, AAA Rule 43 clearly speaks in terms of "remedy or relief" and "compensation" for the arbitration claimant and says nothing about punishing the arbitration defendant. Arbitration is a creature of contract and is carried out under agreed upon rules. Therefore, it is not for the arbitration panel, or for this court, to extend and expand the scope of the proceedings beyond the terms actually agreed upon.

Finally, Haslip is about due process and the protections that must be employed for punitive damages to be permissible in any event. In the arbitration setting we have almost none of the protections that fundamental fairness and due process require for the imposition of this

form of punishment. Discovery is abbreviated if available at all. The rules of evidence are employed, if at all, in a very relaxed manner. The factfinders (here the panel) operate with almost none of the controls and safeguards assumed in Haslip. The proceeding at issue in Haslip was conducted in the Alabama state court system with full appellate review. Here, as noted by the opinion of the court, the scope of review of the arbitrator's award is narrowly limited if not almost nonexistent. "[A]n arbitration award will not be set aside unless it is completely irrational or evidences a 'manifest disregard for law.'" Majority Opinion at 4-5 (citations omitted).

This standard of review, of course, almost completely ignores the review required by Haslip. Why should less be required in an arbitration proceeding if, indeed, punitive damages are within the scope of AAA Rule 43? The simple answer is that the rule doe not contemplate an award of punitive damages. The district court was correct and should be affirmed.

Accordingly, I concur as to Parts I and II of the court's opinion and dissent as to Part III.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS,EIGHTH CIRCUIT

APPENDIX B

United States Court of Appeals

FOR THE EIGHTH CIRCUIT

No. 91-3043MNST
91-3146MNST

Judy Lee,	*
	*
Appellant,	*
	* Appeal from the
	* United States
vs.	* District Court for the
	* District of Minnesota
James John Chica; et al.,	*
	*
Appellees.	*

The motion of the Securities Industry Association, Inc. for leave to file a petition for rehearing en banc as amicus curiae has been considered by the court and is granted.

February 4, 1993

Order Entered at the Direction of the Court:
/s/ Michael E. Gans
Clerk, U.S. Court of Appeals, Eighth Circuit

APPENDIX C

United States Court of Appeals

FOR THE EIGHTH CIRCUIT

No. 91-3043MNST
91-3146MNST

Judy Lee,	*
	*
Appellant,	*
	* Order Denying
	* Petition for
vs.	* Rehearing and
	* Suggestion for
	* Rehearing En Banc
James John Chica; et al.,	*
	*
Appellees.	*

The suggestion for rehearing en banc is denied. Judge Bowman, Judge Magill, Judge Beam, Judge Loken, and Judge Hansen would grant the suggestion for rehearing en banc.

The petition for rehearing is also denied.

March 4, 1993

Order Entered at the Direction of the Court:
/s/ Michael E. Gans

Clerk, U.S. Court of Appeals, Eighth Circuit

APPENDIX D

UNITED STATES DISTRICT COURT

DISTRICT OF MINNESOTA

THIRD DIVISION

Judy Lee,	
Plaintiff,	3-91 Civ 304
v.	
	St. Paul, Minnesota
James Chica and Engler-Budd & Company, Inc.,	August 16, 1991
Defendants.	

TRANSCRIPT OF PROCEEDINGS

[Preceding argument of counsel omitted.]

THE COURT:I think not. I think I am ready to rule.

By the way, both of you have made eloquent and helpful arguments, leaving me as confused as before. But nevertheless, I feel now I have received the best advice I could have to prepare me. We have, as I view it, a

number of issues, but the essential issue for purposes of this hearing is whether or not state law does govern, and the question of who's to be a party of an arbitration contract, whether federal law is reaching into that area as a part of its common law, or whether the rules of construction of a contract should continue to be within the state province as they apply to arbitration contracts, that and the issue of whether punitive damages are to be awarded.

It does seem to me, Mr. Heikes, that you may well be right as to the distinguishability of the Second Circuit case. But it does seem to me that it makes sense that federal law passed the law which applied to arbitration and arbitration agreements which made it nationwide as opposed to what had been previously up to the individual states. It seems to me that if they wanted to preempt the area to that regard, they certainly would want to determine who should or shouldn't be covered by the same.

As to the punitive damages, I am pressed with the problems involved with the whole question of punitive damages, not only as to arbitration awards but, as both of you know, as to the effect on jury awards to the affected parties, as far as that's concerned, as to attempts by legislatures and the Congress to some way get control of them, if that's the word. I think it's probably agreed that punitive damage by themselves serve a good purpose. The question is how do you contain them when they don't. But we don't have that here. I guess I am wavering.

But it does seem to me that there is a dominant theme appearing any time related to punitive damages, and that is that punitive damages must be controlled. I am not arguing my personal belief. I don't intend to. What I'm trying to say is what case law I view in the area. It does seem to be alert to the needs to utilize the same for the purpose for which it was intended. And one

of the ways that can be done is to restrict it to the Court as opposed to disseminating to an agency like a creation such as an arbitration panel.

I am going to grant the motion to modify the arbitration award and to eliminate the punitive damages award, and I'm going to deny the motion to vacate the award. I'm going to grant the petition for confirmation of the award. In essence, that means the punitive damages figure of 31,800 will be stricken. The $10,000 compensatory damage will remain, and the $5,000 for attorneys' fees will also be allowed to remain. It does seem to me this certainly is a case that could well go up and serve to help in the assistance of creating an expanded body of law that governs these matters of arbitration awards.

Are there any questions?

Very well, that will be all.

MR. HEIKES: Thank you, Judge.

MR. WILMES: Thank you, Judge.

CERTIFIED: /s/ Robert W. Riley

APPENDIX E

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION

In the Matter of Arbitration **Court File No. 3-91-304** Between:

Judy Lee,

Claimant,

v.

ORDER

James John Chica and Engler-Budd & Company, Inc.,

Respondents.

A hearing was held before the undersigned District Court Judge on August 16, 1991 on (1) the motion of respondent James J. Chica to vacate the March 1991 arbitration award or, in the alternative, to vacate or modify the award to strike the punitive damage award, and (2) the motion of claimant Judy Lee to confirm the arbitration award. Graham Heikes, Esq. appeared for claimant Judy Lee. Gregory L. Wilmes, Esq. appeared for respondent James J. Chica. Engler-Budd & Company, Inc. did not appear and has not otherwise responded to claimant Judy Lee's motion.

Based upon all the records, files and proceedings, the briefs and arguments of counsel, and in accord with the Court's oral ruling of August 16, 1991,

IT IS HEREBY ORDERED that (1) Respondent James J. Chica's motion to vacate the entire award is denied;

(2) Respondent James J. Chica's motion to vacate the punitive damage portion of the award, or to modify the award to strike the punitive damage award, is granted, and the arbitrators' award of $31,800 in punitive damages is hereby vacated;

(3) Claimant Judy Lee's motion to confirm is granted in part and denied in part. The arbitration award against James John Chica is confirmed, except with respect to the punitive damage award. Accordingly, claimant Judy Lee shall have judgment against respondent James J. Chica in the amount of $10,600.00 for compensatory damages, $5,000.00 for attorneys' fees, and $300.00 for administrative fees, all as awarded by the arbitrators.

(4) Claimant Judy Lee's motion to confirm is denied with respect to the punitive damage portion of the arbitration award directed against James John Chica.

(5) No opposition having been filed by Engler-Budd & Company, Inc., the entire arbitration award is confirmed against Engler-Budd & Company, Inc. Claimant Judy Lee shall have judgment against respondent Engler-Budd & Company, Inc. in the amount of $10,600.00 for compensatory damages, $5,000.00 for attorneys' fees, $300.00 for administrative fees, and $31,800 for punitive damages.

Dated: August 22, 1991

/s/ Robert J. Renner
District Court Judge

LET JUDGMENT BE ENTERED ACCORDINGLY.

APPENDIX F

AMERICAN ARBITRATION ASSOCIATION

SECURITIES ARBITRATION TRIBUNAL

In the Matter of the Arbitration between

JUDY LEE
-AND-
JAMES JOHN CHICA AND ENGLER-BUDD & COMPANY, INC.

CASE NUMBER: 56 136 00251 90

AWARD OF ARBITRATORS

WE, THE UNDERSIGNED ARBITRATORS, having been designated in accordance with the arbitration agreement entered into by the above-named parties and having been duly sworn and having duly heard the proofs and allegations of Judy Lee; and James John Chica and Engler-Budd & Company, Inc. having failed to appear after due notice by mail in accordance with the Securities Arbitration Rules of the American Arbitration Association, hereby FIND that:

1. James John Chica and Engler-Budd & Company, Inc., hereafter referred to as RESPONDENTS, opened a margin account for Judy Lee, hereinafter referred to as CLAIMANT, without informing her of the inherent risks of such an account;

2. RESPONDENTS bought and sold virtually all the securities in the account on a discretionary basis without receiving from CLAIMANT authorization for such discretionary trading;

3. RESPONDENTS, on at least two occasions, failed and refused to execute sell orders of securities that had been requested by CLAIMANT;

4. RESPONDENTS were guilty of fraud and defalcation of their fiduciary duty to CLAIMANT, which arose as a result of the unauthorized discretionary trading.

Therefore, WE AWARD as follows:

RESPONDENTS shall pay to CLAIMANT compensatory damages in the amount of $10,600, punitive damages in the amount of $31,800 , and attorneys' fees in the amount of $5,000, making a total award due to CLAIMANT for FORTY-SEVEN THOUSAND FOUR HUNDRED DOLLARS ($47,400).

The administrative fees and expenses of the American Arbitration Association totaling $300 shall be borne by RESPONDENTS. Therefore, RESPONDENTS shall pay to CLAIMANT the sum of $300 for administrative fees previously advanced by CLAIMANT to the Association.

This Award is in full settlement of all claims submitted to this arbitration.

Dated: 3-11-93 /s/ Allen D. Barnard
Allen D. Barnard, Arbitrator

Dated: 3-16-93 /s/ Joseph William Anthony
Joseph William Anthony, Arbitrator

Dated: 3-16-93 /s/ James A. Lundberg
James A. Lundberg, Arbitrator

APPENDIX G

Minn. Stat. 549.191 (1990) provides:

549.191 CLAIM FOR PUNITIVE DAMAGES

Upon commencement of civil action, the complaint must not seek punitive damages After filing the suit a party may make a motion to amend the pleadings to claim punitive damages. The motion must allege the applicable legal basis under section 549.20 or other law for awarding punitive damages in the action and must be accompanied by one or more affidavits showing the factual basis for the claim. At the hearing on the motion, if the court finds prima facie evidence in support of the motion, the court shall grant the moving party permission to amend the pleadings to claim punitive damages. For purposes of tolling the statute of limitations, pleadings amended under this section relate back to the time the action was commenced.

Minn. Stat. 549.20 (1990) provides:

549.20 PUNITIVE DAMAGES

Subdivision 1. (a) Punitive damages shall be allowed in civil actions only upon clear and convincing evidence that the acts of the defendant show deliberate disregard for the rights of safety of others.

(b) A defendant has acted with deliberate disregard for the rights or safety of others if the defendant has knowledge of facts on intentionally disregards facts that create a high probability of injury to the rights or safety of others and:

(1) deliberately proceeds to act in conscious or intentional disregard of the high degree of probability of injury to the rights or safety of others; or

(2) deliberately proceeds to act with indifference to the high probability of injury to the rights or safety of others.

Subd. 2. Punitive damages can properly be awarded against a master or principal because of an act done by an agent only if:

(a) the principal authorized the doing and the manner of the act, or

(b) the agent was unfit and the principal deliberately disregarded a high probability that the agent was unfit, and

(c) the agent was employed in a managerial capacity with authority to establish policy and make planning level decisions for the principal and was acting in the scope of that employment, or

(d) the principal or a managerial agent of the principal, described in clause (c), ratified or approved the act while knowing of its character and probable consequences.

Subd. 3. Any award of punitive damages shall be measured by those factors which justly bear upon the purpose of punitive damages, including the seriousness of hazard to the public arising from the defendant's misconduct, the profitability of the misconduct to the defendant, the duration of the misconduct and any concealment of it, the degree of the defendant's

awareness of the hazard and of its excessiveness, the attitude and conduct of the defendant upon discovery of the misconduct, the number and level of employees involved in causing or concealing the misconduct, the financial condition of the defendant, and the total effect of other punishment likely to be imposed upon the defendant as a result of the misconduct, including compensatory and punitive damage awards to the plaintiff and other similarly situated persons, and the severity of any criminal penalty to which the defendant may be subject.

Subd. 4. Separate proceeding. In a civil action in which punitive damages are sought, the trier of fact shall, if requested by any of the parties, first determine whether compensatory damages are to be awarded. Evidence of the financial condition of the defendant and other evidence relevant only to punitive damages is not admissible in that proceeding. After a determination has been made, the trier of fact shall, in a separate proceeding, determine whether and in what amount punitive damages will be awarded.

Subd. 5. Judicial review. The court shall specifically review the punitive damages award in light of the factors set forth in subdivision 3 and shall make specific findings with respect to them. The appellate court, if any, also shall review the award in light of the factors set forth in that subdivision. Nothing in this section may be construed to restrict either court's authority to limit punitive damages.

Supreme Court, U.S.
FILED
JUN 30 1993
OFFICE OF THE CLERK

No. 92-1925

In The

Supreme Court of the United States

October Term, 1992

JAMES JOHN CHICA,

Petitioner,

v.

JUDY LEE,

Respondent.

On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Eighth Circuit

MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE* AND BRIEF OF SECURITIES INDUSTRY ASSOCIATION, INC. IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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June 30, 1993

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MOTION OF SECURITIES INDUSTRY ASSOCIATION, INC. FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE* IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Pursuant to Rule 37.2 of the Rules of this Court, Securities Industry Association, Inc. (the "SIA") requests leave to file the accompanying brief as *amicus curiae* in support of the petition for a writ of certiorari (the "Petition"). Counsel for the petitioner has consented to the filing of this brief; counsel for the respondent has withheld consent.

The SIA is a trade association of over 650 securities firms in the United States and Canada that collectively account for approximately 90 percent of the securities

business conducted in North America. Over the past decade, there has been an enormous growth in the number of securities cases submitted to arbitration, with the result that the SIA's members now typically resolve their disputes with customers and employees in arbitration proceedings, rather than burdening the courts with such disputes.[1]

Just as the civil court system has in recent years experienced "an explosion in the frequency and size of punitive damages awards," *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 111 S. Ct. 1032, 1066 (1991) (O'Connor, J., dissenting), however, there has also been a growing and disturbing trend of arbitration panels imposing extremely large awards of punitive damages against securities firms.[2] Such awards by arbitration panels are a matter of enormous concern to the SIA and its members and, if allowed to continue, could threaten the system of resolving such disputes in private arbitration proceedings rather than in the public court system. The decision

---

[1] According to the General Accounting Office, "[i]n the past decade, the number of arbitration cases filed with the securities [self-regulatory organizations] has increased approximately 540 percent, from 830 in 1980 to 5,332 in 1990." United States General Accounting Office, *Securities Arbitration: How Investors Fare* at 18 (May 1992).

[2] A recent newspaper article identified four punitive damages awards in the amount of $1 million or more that were imposed by arbitration panels against securities firms in 1992, which included one award in the amount of $3.5 million. *Los Angeles Times*, at D3 (Jan. 17, 1993). The Petition notes that punitive damages awards totaling almost $30 million were issued in securities arbitrations during the period from May 1989 through June 1992. (Petition at 12).

below holding that punitive damages are available in arbitration proceedings therefore directly impacts the members of the SIA.

Accordingly, the SIA seeks to submit this *amicus curiae* brief to assist the Court in evaluating the public importance and practical consequences of the issues regarding the imposition of punitive damages in arbitration proceedings presented in the Petition. The SIA respectfully requests that its motion for leave to file the accompanying brief as *amicus curiae* be granted for that purpose.

Respectfully submitted,

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BRIEF OF *AMICUS CURIAE* SECURITIES INDUSTRY ASSOCIATION, INC. IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

STATEMENT OF INTEREST OF *AMICUS CURIAE*

Securities Industry Association, Inc. (the "SIA") is a trade association of over 650 securities firms in the United States and Canada that collectively account for approximately 90 percent of the securities business conducted in North America. The decision below – which sanctioned the imposition of punitive damages in a securities arbitration proceeding – presents a matter of enormous concern to the SIA and its members. Allowing the imposition of punitive damages in arbitration proceedings without adequate

procedural protections and meaningful judicial review threatens the private system of dispute resolution which has become the norm in the securities industry. The decision below holding that punitive damages are available in arbitration proceedings therefore directly impacts the members of the SIA.

A more complete description of the interest of the SIA in the punitive damages issue presented in the Petition is set forth in the accompanying motion for leave to file this brief as *amicus curiae* in support of the Petition.

ARGUMENT

The Petition should be granted with respect to its Questions Presented Nos. 1 and 2 concerning the availability of punitive damages in arbitration proceedings.[1]

[1] Questions Presented Nos. 1 and 2 state as follows:

1. Whether the enforcement of a punitive damages arbitration award against petitioner Chica, who was not a party to the arbitration agreement, violated Chica's due process rights where he was not afforded the procedural safeguards available in judicial proceeding and approved by this Court in *Pacific Mut. Life Ins. Co. v. Haslip*, 111 S. Ct. 1032 (1991).

2. Whether, in enacting the Federal Arbitration Act, Congress intended the federal courts to develop a federal common law of contracts preempting state law which reserves to the state the power to punish by punitive damages, thereby subjecting petitioner Chica to a punitive arbitration award prohibited by Minnesota law.

The SIA does not request that the Court grant the Petition insofar as it seeks review of Question Presented No. 3 concerning the enforceability of the arbitration agreement in question.

Review by this Court is necessary because the decision below sanctions the imposition of punitive damages in the absence of the due process procedural protections required by the Court in *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 111 S. Ct. 1032 (1991). The Petition should further be granted because there is a split amongst the circuits concerning whether state or federal law governs the availability of punitive damages in arbitration proceedings.

I. THE IMPOSITION OF PUNITIVE DAMAGES IN ARBITRATION PROCEEDINGS VIOLATES DUE PROCESS.

The enforcement by the court below of the award of punitive damages against petitioner by an arbitration panel violated the Due Process Clause of the Fifth Amendment to the United States Constitution.

Punitive damages are not to be awarded " 'in proceedings lacking the basic elements of fundamental fairness.' " *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 111 S. Ct. 1032, 1038 (1991) (quoting *Browning-Ferris Industries of Vermont, Inc. v. Kelco Disposal, Inc.*, 492 U.S. 257, 276 (1989)). Moreover, if punitive damages are imposed, due process requires "meaningful and adequate [judicial] review" of such awards. *Id.* at 1044.

In *Haslip*, the Court addressed the procedural safeguards necessary to satisfy due process requirements in considering a challenge to an award of punitive damages

by an Alabama jury.[2] The Court first noted that the seven criteria under Alabama law for evaluating awards of punitive damages "impose[d] a sufficiently definite and meaningful constraint on the discretion of Alabama fact finders in awarding punitive damages." 111 S. Ct. at 1045. Noting that both the trial court and the Alabama Supreme Court applied these specific criteria in scrutinizing the punitive damage award by the jury, the Court found that the defendant "had the benefit of the full panoply of Alabama's procedural protections." *Id.* at 1046. The Court concluded that such procedural protections satisfied the necessary due process requirements for an award of punitive damages. *Id.*

Securities arbitration proceedings – which were designed to secure the resolution of claims for compensation in a manner that is more expeditious and economical than that available in the court system – do not have the procedural protections necessary to satisfy the fundamental fairness standard required for the imposition of

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[2] This Court's recent decision in *TXO Production Corp. v. Alliance Resources Corp.*, 1993 Westlaw 220266 (U.S. June 25, 1993), does not alter *Haslip*'s holding that due process requires "meaningful and adequate judicial review" of awards of punitive damages. Indeed, each of the opinions issued in *TXO* recognized that due process requires *some* judicial review of punitive damages awards. *Id.* at 10 (Stevens, J., plurality); at 14 (Scalia, J., concurring); at 28 (O'Connor, J., dissenting).

punitive damages.[3] As Judge Beam noted in the dissenting portion of his opinion below:

> In the arbitration setting we have almost none of the protections that fundamental fairness and due process require for the imposition of this form of punishment. Discovery is abbreviated if available at all. The rules of evidence are employed, if at all, in a very relaxed manner. The factfinders (here the panel) operate with almost none of the controls and safeguards assumed in *Haslip*.

(Petition Appendix at 12-13) (hereinafter cited as "App. ___"). Such streamlined procedures facilitate the expeditious and economical resolution of disputes in an informal setting that allows lay persons to litigate their claims for compensation without the need for counsel. However, such procedures were not intended, and are not constitutionally adequate, to govern the imposition of punishment.

Moreover, as the decision below itself conceded, "judicial review of arbitration awards is narrowly limited and . . . an arbitration award will not be set aside unless it is completely irrational or evidences a 'manifest disregard for law.' " (App. 5); *see also* Federal Arbitration Act

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[3] The arbitration rules of the National Association of Securities Dealers, the New York Stock Exchange and the American Arbitration Association do not expressly address the issue of punitive damages. Accordingly, unlike the Alabama court system addressed in *Haslip* where awards of punitive damages are analyzed in light of seven criteria, arbitrators are not provided with any guidance regarding awards of punitive damages and the arbitration rules place *no* express constraints on such awards.

(the "FAA"), 9 U.S.C. § 10(a) (listing limited bases for challenges to arbitration awards). While such limited review advances the goal of resolving disputes concerning claims for compensation without lengthy appeals, the narrow scope of review in no way provides the "meaningful and adequate judicial review" necessary to satisfy due process requirements for the imposition of punitive damages established in *Haslip*.

More generally, in light of its punitive nature, the extraordinary remedy of punitive damages has no place in private arbitration proceedings which operate outside the public court system. "[P]unitive damages are quasi-criminal punishment." *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 111 S. Ct. 1032, 1062 (1991) (O'Connor, J., dissenting). "For centuries the power to punish has been a monopoly of the State, and not that of any private individual." *Garrity v. Lyle Stuart, Inc.*, 386 N.Y.S.2d 831, 834, 353 N.E.2d 793, 796-97 (Ct. App. 1976) (citation omitted) (holding that New York law does not allow arbitrators to award punitive damages). Accordingly, the power to punish should be "confine[d] to the State and its courts. . . . " 386 N.Y.S.2d at 832, 353 N.E.2d at 795. Allowing arbitration panels, which operate outside the State's court system, to impose such punishment violates that fundamental principle.

In sum, a system that exposes litigants to punitive damages – a type of award that is qualitatively different from an ordinary award of compensation – must have a high level of procedural protection in order to pass muster under the Due Process Clause. Designed with the limited purpose in mind of facilitating the speedy and inexpensive resolution of claims for compensation, the

securities arbitration system does not provide the level of protection constitutionally required for the imposition of the unique sanction of punishment. The enforcement of the award of punitive damages against petitioner was therefore constitutionally invalid and should be vacated.

II. IN HOLDING THAT FEDERAL RATHER THAN STATE LAW GOVERNS THE AVAILABILITY OF PUNITIVE DAMAGES IN ARBITRATION PROCEEDINGS, THE DECISION BELOW IS CONTRARY TO THE DECISIONS OF OTHER CIRCUITS.

The Court should grant the Petition in order to resolve a split amongst the circuits regarding whether federal or state law governs the availability of punitive damages in securities arbitration proceedings. In disregarding the choice-of-law clause selecting Minnesota law and instead applying the FAA, the decision below is directly contradictory to the decisions of the Second and Seventh Circuits in *Barbier v. Shearson Lehman Hutton Inc.*, 948 F.2d 117, 122 (2d Cir. 1991), and *Pierson v. Dean, Witter, Reynolds, Inc.*, 742 F.2d 334, 337-39 (7th Cir. 1984), respectively.[4]

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[4] As the Petition notes, other circuits have utilized the analysis applied in the decision below and similarly held that arbitrators may award punitive damages despite choice-of-law clauses selecting the law of states which prohibit such awards. (Petition at 23). *See Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056, 1062 (9th Cir. 1991); *Raytheon Co. v. Automated Business Systems, Inc.*, 882 F.2d 6, 11 (1st Cir. 1989); *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378, 1387 (11th Cir. 1988).

The arbitration clause at issue specifically provided that "[t]his agreement and its enforcement shall be governed by the laws of the State of Minnesota." (App. 3). Despite this clear language, the decision below determined that federal law – not state law – governed the availability of punitive damages. (App. 10). Concluding that the FAA required application of the rules of the American Arbitration Association and that those rules authorized awards of punitive damages, the decision below rejected petitioner's challenge to the award. (App. 9-10).

The Second Circuit has rendered a directly contradictory decision on this precise issue in vacating an award of punitive damages by an arbitration panel. *Barbier v. Shearson Lehman Hutton Inc.*, 948 F.2d 117, 122 (2d Cir. 1991). Much like the present case, *Barbier* involved an arbitration agreement with a choice-of-law clause that provided that "[t]his agreement shall . . . be governed by the laws of the State of New York." *Id.* Following this Court's decision in *Volt Information Sciences, Inc. v. Board of Trustees*, 489 U.S. 468 (1989), the Second Circuit held that the availability of punitive damages was governed by New York law, which prohibits arbitrators from awarding punitive damages. 948 F.2d at 122 (citing *Garrity v. Lyle Stuart, Inc.*, 386 N.Y.S.2d 831, 353 N.E.2d 793 (Ct. App. 1976)). The Second Circuit therefore applied New York law and ruled that the arbitrators in question exceeded their authority in awarding punitive damages. *Id.* The Seventh Circuit similarly ruled in *Pierson v. Dean, Witter, Reynolds, Inc.*, 742 F.2d 334, 339 (7th Cir. 1984), that an arbitration agreement containing a New York choice-of-

law clause prohibited arbitrators from awarding punitive damages.[5]

These decisions properly follow the guidance of this Court's decision in *Volt Information Sciences, Inc. v. Board of Trustees*, 489 U.S. 468 (1989). In *Volt*, this Court held that the FAA did not preempt the parties' choice of California law, which provided for a stay of arbitration pending the outcome of related litigation. *Id.* at 470. The Court explained that the FAA "simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms." *Id.* at 478. Consistent with that approach, the Court noted that the FAA "does [not] prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement. . . . " *Id.*

Accordingly, under *Volt*, the Minnesota choice-of-law provision in this case should have been applied with respect to the availability of punitive damages. Like New York law, Minnesota law does not authorize arbitrators to award punitive damages.[6] Minnesota law provides that

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[5] More recently, a district court applied the Seventh Circuit's decision in *Pierson* in vacating an award of punitive damages by an arbitration panel when the arbitration agreement contained a New York choice-of-law clause. *See Mastrobuono v. Shearson Lehman Hutton Inc.*, 812 F. Supp. 845, 846-48 (N.D. Ill. 1993).

[6] As the Petition notes, courts in New Mexico and Indiana have also ruled that punitive damages may not be awarded in arbitration proceedings. (Petition at 19 n.4). *See Shaw v. Kuhnel & Assoc., Inc.*, 102 N.M. 607, 698 P.2d 880, 882 (1985) (holding that "power [to award punitive damages] is reserved to the courts"); *United States Fidelity & Guaranty Co. v. DeFluiter*, 456 N.E.2d 429,

punitive damages are available only in "civil actions." Minn. Stat. § 549.20 subd. 1(a). Under Minnesota law, "actions" do not include arbitration proceedings. *See Lucas v. American Family Mut. Ins. Co.*, 403 N.W.2d 646, 650-51 (Minn. 1987) (holding that arbitration proceedings are not "actions" under prejudgment interest statute). Therefore, the decision below erred in not applying Minnesota law and vacating the award of punitive damages by the arbitration panel.

Numerous circuits have addressed the interaction between the FAA and state choice-of-law clauses in arbitration agreements in determining the availability of punitive damages in arbitration proceedings and have reached entirely contradictory results. This split amongst the circuits on this important issue, and the resulting uncertainty, requires definitive resolution by this Court and mandates that the Petition be granted with respect to the issue of the availability of punitive damages in arbitration proceedings.

CONCLUSION

For the foregoing reasons, and for those set forth in the Petition, this Court should grant the Petition with respect to the Questions Presented Nos. 1 and 2 in the

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432 (Ind. App. 1983) (holding that "punitives are unavailable because parties may not contract to benefit from or be penalized by punitive damages").

Petition concerning the availability of punitive damages in securities arbitration proceedings.

Respectfully submitted,

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